APPENDIX

(1) District Court's Judgment.

[Caption Omitted]

THIS CAUSE HAVING COME ON FOR TRIAL before the Court and a jury on May 22, 1969, both parties appearing by counsel and the Court having instructed the jury to find a special verdict based upon certain interrogatories and the jury having rendered its special verdict; and the amount of the recovery decreed herein, if any, has been agreed to by the parties.

THEREFORE, IT IS ORDERED, ADJUDGED, AND DECREED that for the taxable year 1963, the plaintiff, The Business Development Corporation of North Carolina, recover from the defendant the amount of $49,400.00 in federal income tax, with interest at six per cent per annum from September 18, 1967, and statutory interest in the amount of $10,164.22, with interest at six per cent per annum from September 18, 1967.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that for the taxable year 1964, the plaintiff, The Business Development Corporation of North Caroline, recover from the defendant the amount of $60,000.00 in federal income tax, with interest at six per cent per annum from September 18, 1967, and statutory interest in the amount of $8,739.45, with interest at six per sent per annum from September 18, 1967.

IT IS FURTHER ORDERED, ADJUDGED, AND DECREED that the costs of this action shall be taxed to the defendant.

Dated this 9th day of June, 1969.

/s/ RICHARD B. KELLAM
Richard B. Kellam
Judge,
United States District Court

(2) Defendant's Motion for Judgment Notwithstanding the Verdict or, in the Alternative, for a New Trial.

[Caption Omitted]

The defendant, United States of America, by and through its attorney, Robert H. Cowen, United States Attorney for the Eastern District of North Carolina, pursuant to Rule 50(b) of the Federal Rules of Civil Procedure, moves the Court to enter judgment in favor of defendant notwithstanding the verdict, or, in the alternative, to grant defendant a new trial.

As grounds for its motion for judgment notwithstanding the verdict, the defendant states:

1. That the defendant is entitled to judgment as a matter of law because plaintiff failed to prove that the Commissioner of Internal Revenue abused his discretion in not allowing an addition to its bad debt reserve in each of the years 1963 and 1964.

2. That this Court erred in not granting defendant's motion for a directed verdict at the close of all the evidence. The evidence and the inferences to be drawn therefrom at that time were such that reasonable men could not differ as to the conclusions to be drawn.

As grounds for its alternative motion for a new trial, the defendant states:

1. That the Court erred in admitting the deposition of Luther H. Hodges, or, in the alternative, the Court erred in admitting opinion testimony of Luther H. Hodges and erred in failing to strike his testimony regarding reserves for losses allowed other financial institutions.

2. That the Court erred in allowing H. Powell Jenkins to testify that a consideration of reserves allowed other financial institutions entered the plaintiff's reasoning as to the adequacy of its own reserves;

3. That the Court erred in allowing H. Powell Jenkins to testify as to categories of problem loans on which plaintiff had sustained no loss;

4. That the Court erred in allowing the testimony and opinion of David J. Duggan;

5. That the Court erred in allowing the testimony and opinion of David R. Clifford;

6. That the Court erred in charging the jury that "the fact that there has been in the past no substantial losses in respect to the plaintiff's loans does not require the conclusion that there is no reasonable risk of loss, or that such losses may not be reasonably anticipated to occur in the future in the ordinary course of plaintiff's business."

In support of this motion the Court's attention is respectfully directed to the supporting brief filed by the defendant.

/s/ ROBERT H. COWEN
United States Attorney

(3) District Court's Order in Defendant's Motion for Judgment Notwithstanding the Verdict or, in the Alternative, for a New Trial.

[Caption Omitted]

United States of America filed a "Motion for Judgment Notwithstanding the Verdict or, in the Alternative, for a New Trial" in this case. On the issues joined, the jury answered each of the interrogatories submitted to them favorably to plaintiff. With one exception, the charge given the jury was not objected to. That exception if well taken is harmless.

The jury determined the plaintiff had carried its burden of proof, hence the evidence is to be viewed in the light most favorable to plaintiff. If there is any basis for the jury's finding, the Court is bound by the verdict. *Scutilles* v.

Inter-Caribbean Shipping Corp., 361 U.S. 107, 4 L.Ed. 2d 142, 80 S. Ct. 173 (1959); *Richmond Television Corp. v. United States*, 354 F. 2d 410, 413 (4th Cir. 1965). No evidence was offered by defendant. The evidence and proper inferences to be drawn therefrom justify the verdict. The motion is therefore DENIED.

/s/ RICHARD B. KELLAM
Richard B. Kellam, Judge
United States District Court

Norfolk, Virginia
June 24th, 1969.

(4) Opinion of the Court of Appeals.

Before Bryan and Butzner, Circuit Judges, and Jones, District Judge.

Albert V. Bryan, Circuit Judge:

Deficiencies were assessed in Federal income taxes for 1963 and 1964 against The Business Development Corporation of North Carolina, and it sues to recapture the payment of these amounts, as permitted by 26 USC 7422(a). A jury had found a verdict favoring the taxpayer. The Government moved to set it aside and give a judgment non obstante dismissing the action. The District Court denied the request, but we think unadvisedly.

Business Development since April 1, 1956, the year of its organization, has been in business in North Carolina as a lender of funds to enterprises needing financial aid for expansion or desiring moneys to commence business operations. To qualify as a borrower, the taxpayer required the applicant to prove an unsuccessful attempt to procure the loan from customary banking institutions. Business Development's own capital came principally from North Carolina sources, designated as "members" of the corporation, and also from the Small Business Administration of the United States.

Section 166(c) of the Internal Revenue Code of 1954 permits the establishment of a bad debt reserve, as follows:

"*§ 166. Bad debts*

(a) General rule.—

(1) Wholly worthless debts.—There shall be allowed as a deduction any debt which becomes worthless within the taxable year.

* * * *

(c) Reserve for bad debts.—In lieu of any deduction under subsection (a), there shall be allowed (in the discretion of the Secretary or his delegate) a deduction for a reasonable addition to a reserve for bad debts."

Availing itself of 166(c), Business Development between 1957 and 1959 deducted from its taxable income $72,751.08, creating a reserve. In 1960 the executive heads ordered additional deductions to raise the reserve to a sum equal to 5% of the taxpayer's outstanding loans. Like action in 1964 enlarged the account to 15%.

The Internal Revenue Commissioner's determination that the deductions through 1962 were sufficient to take care of estimated losses, and his refusal to permit the further deductions sought by the taxpayer under the increased percentages, amounting to $95,000.00 in 1963 and $120,000.00 in 1964, generated the reclamation of taxes now pressed. The Commissioner's defense is that the amount of any "deduction" for an "addition" to a reserve is left by the statute to his discretion, and that he has not in the circumstances of this case breached that trust.

The case went to the jury on special inquiries. The interrogatories with the answers were as follows:

"We, the jury, answer the following interrogatories as follows:

"Interrogatory Number 1:

"Was the Commissioner arbitrary in disallowing the claimed deduction of $95,000 for bad debt reserve

of The Business Development Corporation of North Carolina for the year 1963?

"Answer:
"Yes.

"Interrogatory Number 2:
"What would have been a reasonable addition to the reserves of The Business Development Corporation of North Carolina for the year 1963?

"Answer:
"95,000.

"Interrogatory Number 3:
"Was the Commissioner arbitrary in disallowing the claimed deduction of $120,000 for bad debt reserve of The Business Development Corporation of North Carolina for the year 1964?

"Answer:
"Yes.

"Interrogatory Number 4:
"What would have been a reasonable addition to the reserves of The Business Development Corporation of North Carolina for the year 1964?

"Answer:
"120,000."

In Smoot Sand & Gravel Corp. v. Commissioner, 274 F2d 495, 501 (4 Cir.), cert. denied 362 US 976 (1966), we said:

> "The purpose of the reserve is (1) to charge the loss against the period *in which it was actually incurred* as a result of the sale of goods to customers whose accounts subsequently prove to be uncollectible and (2) to show the estimated realizable value of the customers' accounts." (Accent added.)

Over the six years prior to 1963, Business Development's accumulated reserve came to $318,387.58 through average annual deductions of $53,064.60 for additions. In 1963, taxpayer suffered its first loss. It amounted to $28,037.72. Although at that time the reserve was adequate to absorb losses of 10 times that amount, the taxpayer deducted—and added—for the year 1963 $95,000.00.

By the end of 1964 Business Development had sustained an additional loss of $23,015.66. At that point its reserve was $385,349.86, but nevertheless it claimed a tax deduction-addition for that year of $120,000.00. This sum carried the reserve to $482,334.20 by the end of 1964, despite the only losses experienced through that period had been $51,053.38. Perfectly evident, then, was that the reserve of $318,387.55 at the beginning of 1963 was generously adequate without the additions asserted for 1963 and 1964.

Against these figures, the taxpayer, denying the two attempts as excessive, offered only opinion evidence of what sums should have been added in 1963 and 1964. Business Development had the two-fold burden, under section 166(c), of demonstrating that the proposed increments were "reasonable" and the Commissioner's refusal an abuse of discretion. Conceding arguendo that opinion evidence was admissible, we find it wholly failed to establish that the Commissioner was unreasonable or violated his discretion. See Patterson v. Pizitz, Inc., 353 F2d 267 (5 Cir. 1965), cert. denied 383 US 910 (1966).

The Government's motion was the equivalent of a request for a directed verdict. A direction should be granted where there is "no substantial evidence to support" the verdict asked of the jury. Hawkins v. Sims, 137 F2d 66, 67 (4 Cir. 1943). Furthermore, even though resolution of inferences must be left to the jury, nevertheless "it is the duty of the court to withdraw the case from the jury when the necessary inference is so tenuous that it rests merely upon speculation and conjecture." Ford Motor

Co. v. McDavid, 259 F2d 261, 266 (4 Cir.), cert. denied 358 US 908 (1958). That is this case.

In our view judgment should have been entered for the Government on its motion.

Reversed.

(5) Judgment of the Court of Appeals.

[Caption Omitted]

APPEAL FROM the United States District Court for the Eastern District of North Carolina.

THIS CAUSE came on to be heard on the record from the United States District Court for the Eastern District of North Carolina, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now here ordered and adjudged by this Court that the judgment of the said District Court appealed from, in this cause, be, and the same is hereby, reversed.

s/SAMUEL W. PHILLIPS, *Clerk*

Filed: June 24, 1970

In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 735

THE BUSINESS DEVELOPMENT CORPORATION OF NORTH CAROLINA, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The district court did not render an opinion. The the opinion of the court of appeals (Pet. App. 4a-8a) is reported at 428 F. 2d 451.

JURISDICTION

The judgment of the court of appeals was entered on June 24, 1970 (Pet. App. 8a). The petition for a writ of certiorari was filed on September 21, 1970.